

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
F. W. WOOLWORTH CO.)

Appearances:

For Appellant: Raymond T. Munsell and
Nicholas S. Freud
Attorneys at Law

For Respondent: John D. Schell
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of F. W. Woolworth Co. against proposed assessments of additional franchise tax in the amounts of \$35,513.98, \$33,318.87, and \$37,259.75 for the income years 1961, 1963, and 1964, respectively.

The above assessments were based upon a determination by respondent that the appellant, a Canadian subsidiary (F. W. Woolworth Co., Ltd.), and a Mexican subsidiary (F. W. Woolworth Co., S.A. de C.V.) were all engaged in a single unitary business operation during the years in question. Appellant does not dispute that its business in the United States is unitary, and it has filed its returns and paid franchise tax in California on that basis since 1939. After this appeal was filed, respondent conceded that appellant's Mexican subsidiary was not a part of that unitary business and that it was therefore properly excluded from the combined report. As a result of that concession, the proposed assessments are reduced to \$34,795.46, \$31,740.54, and \$34,677.56 for the income years 1961, 1963, and 1964, respectively. The sole question remaining for decision therefore, is whether

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appellant and its Canadian subsidiary, F. W. Woolworth Co., Ltd., were engaged in a unitary business operation during those years.

The appellant, F.W. Woolworth Co., is a New York corporation with its executive offices in New York city. In 1879, its founder, Frank W. Woolworth, opened the first Woolworth's variety or "five-and-ten cent" store in Lancaster, Pennsylvania. Since that date appellant's retail variety business has expanded steadily and as of the close of 1964, the last year on-appeal, it was operating 2,106 variety stores throughout the United States and Canada. In addition, Woolworth stores located in Canada; Mexico, the British Isles, and Germany are operated by wholly owned or majority owned foreign subsidiaries of appellant. The aggregate of Woolworth stores constitutes the largest variety chain in the world. In each of the years in question, the group's annual gross sales exceeded one billion dollars.

Appellant does no manufacturing; its entire business consists of purchasing merchandise at wholesale and reselling it directly to consumers at retail through its own stores. Appellant's concededly unitary business organization in the United States and Puerto Rico is divided into ten geographic districts, each of which is managed by a district manager who is responsible for the operation of all stores in his district. Centralized purchasing, accounting, advertising, and financing are furnished to all districts by the executive headquarters in New York City. Uniform management and operations policies are administered for all of appellant's stores.'

In 1912 appellant acquired S. H. Knox & Co., a retail store located in London, Ontario, Canada. That acquisition marked the beginning of appellant's wholly owned Canadian subsidiary, F. W. Woolworth Co., Ltd. (Canada), which has its headquarters in Toronto. During 1964 F. W. Woolworth Co., Ltd. operated 277 variety stores in Canada. Its operations are conducted exclusively in Canada and are substantially similar to those of appellant in the United States and Puerto Rico, although product lines differ somewhat because of the distinct Canadian market. In years prior to 1960, operations of the Canadian company were reported as a district of appellant rather than as a subsidiary corporation.

During the years in question the president of both appellant and its Canadian subsidiary was Mr. Robert C. Kirkwood. All six directors of F. W. Woolworth Co., Ltd., were also on appellant's board of directors, and five of those six were on appellant's eight-man executive

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committee of directors. Those same five men were officers of the Canadian subsidiary. In each year a majority of the officers of the Canadian company were also officers or directors of appellant. Meetings of appellant's board of directors were held at its headquarters in New York City and the managing director of the Canadian subsidiary, who was also a director of appellant, was frequently in attendance at those meetings.

-Full day-to-day management of F. W. Woolworth Co., Ltd., is vested in its managing director, a Canadian resident. The Canadian subsidiary does all its own purchasing, primarily from Canadian suppliers, and its independent staff of buyers all reside in Canada. Apparently some of the Canadian suppliers are Canadian subsidiaries of United States firms with which appellant does business. During the years on appeal at least 90 percent of the goods which F. W. Woolworth Co., Ltd., acquired were purchased from Canadian sources. Appellant and its Canadian subsidiary do purchase some goods from the same foreign suppliers; e.g., goods manufactured in Japan. During the years 1961 through 1964 appellant purchased no goods from F. W. Woolworth Co., Ltd. The Canadian company did purchase 'small amounts of sample goods in each year from its parent (\$1,793.20, \$973.82, and \$1,254.29 in the income years 1961, 1963, and 1964, respectively.)

F. W. Woolworth Co., Ltd., operates in Canada substantially autonomously of parental control by appellant. It does not participate in any of the centralized functions maintained by its parent company in the United States. The Canadian corporation has its own accounting and advertising departments. It hires its own Canadian personnel, and conducts management and sales training programs which are independent of appellant's. F. W. Woolworth Co., Ltd., negotiates its own financing, subject to the approval of appellant's Executive Committee. Decisions as to new store locations, or to close existing stores, and leasing and subleasing arrangements are made by the Canadian company subject to the approval of its parent.

All of the stores of appellant and F. W. Woolworth co., Ltd. (Canada), bear the Woolworth name. In many instances common trademarks and trade names are used? although appellant contends there are no trademark licensing agreements between it and its Canadian subsidiary and the subsidiary is free to use the trademark or trade name in any way it chooses. The parent owns no Canadian trademark registrations and the Canadian company has no such registrations in the United States., All Woolworth stores

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use the slogan "Satisfaction Guaranteed -- Replacement or Money Refunded" as their seal of quality. That slogan is uniformly printed around a red diamond-shaped design bearing the company name.

During the years in question appellant conducted the largest food service operation in the world. Its restaurants, counter units, and in-store cafeterias in the United States, were perennially the company's largest dollar volume producer. Food service facilities were also maintained in Canada by F. W. Woolworth Co., Ltd. Parent and subsidiary operated their food supply businesses substantially -autonomously of one-another, although there was some exchange of recipes-and test kitchen findings. Several times a year employees of appellant's and the Canadian subsidiary's food service divisions visited one another to obtain information about each other's operations.

In 1961, appellant announced to its stockholders that it was establishing a new division, the Woolco Department Stores division, which would operate a chain of mass-selling, low margin department stores in the United States and Canada. F. W. Woolworth Co., Ltd. (Canada), formed a similar operating division. In this regard appellant's 1961 Annual Report stated:, on page 3:

At this time, your Management can report that the Woolco Department Stores division is in existence with headquarters in the Woolworth Building in New York. Its executive staff has been drawn primarily from within F. W. Woolworth Co. Except for leased departments, its merchandise is being obtained by Woolworth buyers, and your Company's firmly established policy of "Satisfaction Guaranteed-- Replacement or Money Refunded" will be in effect for Woolco customers. In the Spring of 1962, the first United States store will open at Columbus, Ohio, and the first Canadian store at Sudbury, Ontario; It is expected that several more units will be opened during the year on both sides of the border, primarily in existing shopping developments.

The management of the new Woolco Department Stores division was further described in that annual report, on page 8, as follows:

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The nucleus of the executive organization of Woolco Division has been drawn from executive personnel within the F. W. Woolworth Co. Each individual has been a member of the Woolworth organization for more than 20 years. Together they represent intensive training and experience in all phases of the Company's policies and methods and the division's headquarters have been established in the Woolworth Building, New York.,..

As planned, the first Woolco store opened in Columbus, Ohio, on June 6, 1962, Appellant described it as "the prototype of all units with respect to appearance and merchandise layout, with due allowance for modifications -prescribed by local community characteristics," (Annual Report, 1962, page 3.) By the close of 1962 six additional Woolco stores were operating -- two in the United States and four in Canada, In its 1962 Annual Report, at page 20, appellant further outlined the management of the Woolco Division as follows:

...It is headed by a General Manager, whose career at Woolworth's was characterized by a strong ability to organize. He directs a staff of executives with wide experience in the effective use of the most modern procedures in the intensely competitive field of mass merchandising, Department by department, the Woolco Division is supported by the entire F. W. Woolworth Co. Management team -- from site selection to check-out,

The Woolco stores in both the United States and Canada proved to be a successful business venture for appellant and its Canadian subsidiary. A large selection of merchandise was offered, including such items as ready-to-wear, major household appliances, television, radios and record players, sporting goods, camera equipment, jewelry, tires, and auto supplies. Unlike the cash and carry variety stores, the Woolco stores extended both revolving credit and time payment plans to their customers. As the year 1964 ended, 16 Woolco stores had been opened, 9 in the United States and 7 in Canada, and more were in the planning and construction stages,

Section 25101 of the Revenue and Taxation Code requires a taxpayer deriving income from sources within and without California to measure its California franchise

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tax liability by the net income derived from or attributable to sources within this state. If the taxpayer's business is unitary, the income attributable to California sources must be determined by formula apportionment rather than by the separate accounting method. (Butler Bros. v. McColgan, 17 Cal. 2d 664 [111 P.2d 334], aff'd, 315 U.S. 501 [86 L. Ed. 991].) As earlier stated, the sole question for decision here is whether, as contended by respondent, the Canadian operations of F. W. Woolworth Co., Ltd., were a part of appellant's concededly unitary business in the United States. If so, the income from those Canadian operations must be included in appellant's unitary income subject to apportionment.

The California Supreme Court has set forth two *general tests for determining whether a business is unitary. In Butler Bros. v. McColgan, supra, it held that the existence of a unitary business is definitely established by the presence of: (1) unity of ownership; (2) unity of operation, as evidenced by central purchasing, advertising, accounting and management division; and (3) unity of use in its centralized executive force and general system of operation. Subsequently, in Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 [183 P.2d 16], the court stated that a business is unitary when the operation of the business within California contributes to or is dependent upon the operation of the business outside the state. --In later cases these general tests have been reaffirmed and have been given broad application, (Superior Oil Co. v. Franchise Tax Board, 60 Cal. 2d 406 [34 Cal. Rptr. 545, 386 P.2d 33]; Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417 [34 Cal. Rptr. 552, 386 P.2d 40]; RKO Teleradio Pictures, Inc. v. Franchise Tax Board, 246 Cal. App. 2d 812 [55 Cal. Rptr. 299].) The California courts have yet to clearly delimit the unitary business concept, except to state? "It is only if [a foreign corporation's] business within this state is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used." (Butler Bros. v. McColgan, supra, 17 Cal. 2d 664,

In support of its contention that the Canadian operations of F.W. Woolworth Co., Ltd., are completely separate from and independent of appellant's domestic unitary business, appellant places substantial weight on the alleged lack of the required unities of operation and use between appellant and its Canadian subsidiary,

We agree with appellant that unity of operation as evidenced by centralization of purchasing and other functions is virtually nonexistent in the instant case. We are not so convinced of the absence of unity of use.

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However, we do not read the Butler Bros. case and subsequent decisions to say that unless, the three unities are present a business cannot be found to be unitary. Those cases merely state that if the three unities are present, then the unitary nature of the business is established. A unitary business may also exist, however, if the alternative Edison test is satisfied, i.e., if the business carried on within the state contributes to or is dependent upon the operation of the business outside California. Applying this latter test to the facts before us, we must conclude that during the years under review appellant and its Canadian subsidiary were engaged in a single unitary enterprise.

In spite of the apparent autonomy of the operations in Canada of F.W. Woolworth Co., Ltd., we are of the opinion that its business is strongly linked to appellant's unitary business in the United States. During the years on appeal a handful of executives served as members of appellant's Executive Committee of directors and as officers of appellant. Those same gentlemen composed the entire board of directors of the Canadian subsidiary and served as officers of that company as well. Meetings of appellant's directors were held frequently at appellant's headquarters in New York City. Since the Canadian company's directors were all members of appellant's board of directors, it seems extremely likely that joint meetings often took place in New York City.

The significance of the integration of executive forces as a unitary factor was recently emphasized by the District Court of Appeal in its decision in Chase Brass & Copper Co., Inc. v. Franchise Tax Board, 10 Cal. App. 3d 496 [87 Cal. Rptr. 239], appeal dismissed and cert. denied, 400 U.S. 961 [27 L. Ed. 2d 381], as follows:

The integration of executive forces is an element of exceeding importance. It is top level management which is credited (or in case of failure or indifferent results, debited) with the effects of corporate enterprises. Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, and to exert their best efforts, not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott [the parent corporation] is an invaluable resource

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The "major policy matters" are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the concern of Kennecott....

It is true that the president of Chase [one of the subsidiaries] had a complete staff and line organization under his direction, but executive control at the highest level was in Kennecott. (10 Cal, App. 3d 496, 504.)

Similarly, as between appellant and F. W. Woolworth Co., Ltd., executive control at the highest level was in appellant as a result of the substantial integration of their executive forces.

It was this common top management team that decided in 1961 that Woolworth's should branch out into the full-line department store business. The formation in that year of appellant's Woolco Department Stores division was an example of appellant's continued attempts to keep up with consumer demands. Although a Woolco Division was also formed by F. W. Woolworth Co., Ltd., it appears that all of the planning and site selection, as well as the operational and policy decisions with respect to the Woolco department stores in the United States and Canada, emanated from appellant's headquarters in New York. That is where executive control at the highest level was maintained.

There were several other unitary aspects to the relationship between appellant and F. W. Woolworth Co., Ltd. (Canada). Appellant concedes that there were frequent exchanges of information and know-how between its executives and those of the Canadian company. The relatively small amounts of intercompany sales charged by appellant to its Canadian subsidiary often consisted of "hot items" of merchandise which it was thought might be marketable in Canada. The famous Woolworth name was attached to all Canadian operations. Common trademarks, trade names and slogans identifiable with Woolworth's were also used in Canada. Appellant and F. W. Woolworth Co., Ltd., purchased some goods from the same foreign suppliers, and the Canadian company's purchases of goods in Canada were sometimes from Canadian subsidiaries of appellant's suppliers in the United States.

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Viewing the entire factual picture we believe that appellant's operations clearly contributed to the success of F.W. Woolworth Co., Ltd., in Canada. Certainly it cannot be said that the businesses of the two corporations were "truly separate and distinct", as that phrase is used in the Butler Bros. case, so that separate accounting may properly be used. It is impossible to place dollar values on the Woolworth name, on exchanges of information and know-how, or on the expertise of men who grew up with appellant's variety store operation. It is similarly impossible to deny that such values exist, or to minimize their importance in a highly competitive merchandising business. When faced with such valuation difficulties, it seems a particularly appropriate time to apply formulary apportionment and its inherent approximations .

We therefore conclude that F. W. Woolworth Co., Ltd. (Canada) , was a part of appellant 's concededly unitary operations in the United States, and the net income of that Canadian subsidiary should therefore have been included in appellant's unitary income subject to apportionment .

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of F. W. Woolworth Co. against proposed assessments of additional franchise tax in the amounts of \$35,513.98, \$33,318.87, and \$37,259.75 for the income years 1961, 1963, and 1964, respectively, be modified in accordance with the concession of the Franchise Tax Board that appellant's Mexican subsidiary, F. W. Woolworth, Co., S.A. de C.V., was not a part of appellant's unitary business operation during those years. This concession results in a reduction of the proposed assessments to \$34,795.46, \$31,740.54, and \$34,677.56 for the income years 1961, 1963, and 1964, respectively. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 31st day of July, 1972, by the State Board of Equalization.

_____, Chairman

Geoffrey, Member

William L. Brown, Member

Paul R. Gloor, Member

_____, Member

ATTEST: W. W. Hendon, Secretary